DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–145474–11]

RIN 1545–BK71

Use of Differential Income Stream as an Application of the Income Method and as a Consideration in Assessing the Best Method

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of proposed rulemaking.

SUMMARY: In the Rules and Regulations section of this issue of the Federal Register, temporary regulations provide guidance on how an analysis of the differential income stream may provide a best method consideration for evaluating an application of the income method to determine taxable income in connection with a cost sharing arrangement. The text of those regulations also serves as the text of regulations that are proposed by cross-reference to the temporary regulations. This document also contains proposed regulations providing guidance on the use of the differential income stream as a specified application of the income method to determine taxable income in connection with a cost sharing arrangement.

DATES: Written or electronic comments and requests for a public hearing must be received by March 22, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–145474–11), Room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–145474–11), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (IRS REG–145474–11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Joseph L. Tobin or Mumal R. Hemrajani, (202) 435–5265 (not a toll-free number); concerning submission of comments and/or requests for a hearing, Richard.A.Hurst@irs.counsel.treas.gov.

SUPPLEMENTARY INFORMATION:

Background

A notice of proposed rulemaking and notice of public hearing regarding additional guidance to improve compliance with, and administration of, the rules in connection with a cost sharing arrangement (CSA) were published in the Federal Register (70 FR 51116) (REG–144616–05) on August 29, 2005 (2005 proposed regulations). A correction to the notice of proposed rulemaking and notice of public hearing was published in the Federal Register (70 FR 56611) on September 28, 2005. A public hearing was held on December 16, 2005.

The Treasury Department and the IRS received numerous comments on a wide range of issues addressed in the 2005 proposed regulations. In response to these comments, temporary and proposed regulations were published in the Federal Register (74 FR 340–01 and 74 FR 236–01) (REG–144615–02) on January 5, 2009 (2008 temporary regulations). Corrections to the 2008 temporary regulations were published in the Federal Register on February 27, 2009 (74 FR 8863–01), March 5, 2009 (74 FR 9570–01, 74 FR 9570–02, and 74 FR 9577–01), and March 19, 2009 (74 FR 11644–01). A public hearing was held on April 21, 2009.

The Treasury Department and the IRS received comments on a range of issues addressed in the 2008 temporary regulations. Final regulations were issued in a previous issue of the Federal Register (REG–144615–02) (TD 9568) in December 2011 (final regulations). Certain guidance regarding discount rates was reserved in the final regulations because the Treasury Department and the IRS believe it is appropriate to solicit public comments on that subject matter.

Temporary regulations (TD 9569) in the Rules and Regulations section of this issue of the Federal Register contain amendments to the final regulations and implement the use of the differential income stream as a consideration in assessing the best method in connection with a CSA. The text of those regulations also serves as the text of the regulations contained in this document that are proposed by cross-reference to the temporary regulations (§ 1.482–7T(g)(2)(v)(B)(2) and (4)(vi)(F)(2)). This document also contains a proposed amendment to the regulations under section 482 that describes the specific application of the income method using the differential income stream (§ 1.482–7(g)(4)(v)).

Explanation of Provisions

See the Explanation of Provisions for the temporary cost sharing regulations published in this issue of the Federal Register for an explanation of how proposed § 1.482–7(g)(2)(v)(B)(2) and (4)(vi)(F)(2) build upon and augment § 1.482–7(g)(4)(vi)(F)(1) (Reflection of similar risk profiles in cost sharing alternative and licensing alternative) of the final regulations.

These proposed regulations also build upon and augment § 1.482–7(g)(4)(vi)(F)(1) of the final regulations by providing a new specified application of the income method. Section 1.482–7(g)(4)(v) of the proposed regulations provides that the determination of the arm’s length charge for the PCT Payment can be derived by discounting the differential income stream at an appropriate rate. The differential income stream approach to determining PCT Payments depends on reliably determining the discount rate associated with the differential income stream. This, in turn, requires an understanding of the economic meaning of the differential income stream. For example, assume a CSA in which the PCT Payor does not contribute any platform or operating contributions, and undertakes only routine exploitation activities for which it anticipates a routine return. In such case, the total undiscounted anticipated profits (before PCT Payments) to the CSA in the PCT Payor’s territory can be thought of as comprising the anticipated routine exploitation profits plus the anticipated development value of the cost shared intangibles in the PCT Payor’s territory. Under the licensing alternative, on the other hand, the PCT Payor’s total undiscounted anticipated profits consist solely of the anticipated routine exploitation profits. Thus, the differential income stream conceptually corresponds to the development value of the cost shared intangibles. For these reasons, an appropriate discount rate for the differential income stream might be determined based, for example, on the weighted average cost of capital of uncontrolled companies whose activities consist primarily of developing intangibles similar to the cost shared intangibles, and whose resources, capabilities, or rights are similar to the platform contributions and cost shared intangibles under the CSA. These proposed regulations also add § 1.482–7(g)(4)(viii) Example 9 to illustrate this newly specified application of the income method.
Proposed Effective Dates

Prop. Treas. Reg. § 1.482–7(g)(2)(v)(B)(2), (4)(v)(F)(2) and (viii), Example 8 are proposed to be applied to taxable years beginning on or after December 19, 2011.

Prop. Treas. Reg. § 1.482–7(g)(4)(v)(F)(2) and (viii), Example 9 are proposed to apply to taxable years beginning on or after the date of publication of a Treasury decision adopting such rules as final regulations in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 702(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration (CCASBA) for comment on their impact on small businesses. CCASBA had no comments.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Treasury and the IRS request comments on all aspects of the proposed rules. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the Federal Register.

Drafting Information

The principal authors of these proposed regulations are Joseph L. Tobin and Mamul R. Hemrajani, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1
Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Authority: 26 U.S.C. 7805 * * *
Section 1.482–7 is also issued under 26 U.S.C. 482. * * *

Par. 2. Section 1.482–7 is amended by adding paragraphs (g)(2)(v)(B)(2), (g)(4)(v), and (g)(4)(v)(F)(2), and Examples 8 and 9 to paragraph (g)(4)(viii).

The additions read as follows:

§ 1.482–7 Methods to determine taxable income in connection with a cost sharing arrangement.

* * * * *

(g) * * * * *

(2) * * *

(v) * * *

(B) * * *

(2) [The text of the proposed amendment to § 1.482–7(g)(2)(v)(B)(2) is the same as the text of § 1.482–7T(g)(2)(v)(B)(2) published elsewhere in this issue of the Federal Register].

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(4) * * *

(v) Application of income method using differential income stream.

In some cases, the present value of an arm’s length PCT Payment may be determined as the present value, discounted at the appropriate rate, of the PCT Payor’s reasonably anticipated stream of positive or negative income or expense over the duration of the CSA Activity that would result (before PCT Payments) from undertaking the cost sharing alternative rather than the licensing alternative (differential income stream). See Example 9 of paragraph (g)(4)(viii) of this section.

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(vi) * * *

(F) * * *

(2) [The text of the proposed amendment to § 1.482–7(g)(4)(v)(F)(2) is the same as the text of § 1.482–7T(g)(4)(v)(F)(2) published elsewhere in this issue of the Federal Register].

* * * * *

(viii) * * *

Example 8. [The text of the proposed amendment to § 1.482–7(g)(4)(viii) (Example 8) is the same as the text of § 1.482–7T(g)(4)(viii) (Example 8) published elsewhere in this issue of the Federal Register].

Example 9. The facts are the same as in Example 1, except that additional data on discount rates are available that were not available in Example 1. The Commissioner determines the arm’s length charge for the PCT Payment by discounting at an appropriate rate the differential income stream associated with the rights contributed by USP in the PCT (that is, the stream of income in column (11) of Example 1). Based on an analysis of a set of public companies whose resources, capabilities, and rights consist primarily of resources, capabilities, and rights similar to those contributed by USP in the PCT, the Commissioner determines that 15% to 17% is an appropriate range of discount rates to use to assess the value of the differential income stream associated with the rights contributed by USP in the PCT. The Commissioner determines that applying a discount rate of 17% to the differential income stream associated with the rights contributed by USP in the PCT yields a present value of $446 million, while applying a discount rate of 15% to the differential income stream associated with the rights contributed by USP in the PCT yields a present value of $510 million. Because the taxpayer’s result, $446 million, is within the interquartile range determined by the Commissioner, no adjustments are warranted. See paragraphs (g)(2)(v)(B)(2), (g)(4)(v), and (g)(4)(v)(F)(2) of this section.

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(l) Effective/Applicability Dates.

Treas. Reg. § 1.482–7(g)(2)(v)(B)(2), (g)(4)(v)(F)(2) and (g)(4)(viii), Example 8 apply to taxable years beginning on or after December 19, 2011. Treas. Reg. § 1.482–7(g)(4)(v) and (viii), Example 9 apply to taxable years beginning on or after the date of publication of a Treasury decision adopting these rules as final regulations in the Federal Register.

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Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

[FR Doc. 2011–32730 Filed 12–19–11; 11:15 am]

BILLING CODE 4830–01–P

DEPARTMENT OF THE INTERIOR

Office of Surface Mining Reclamation and Enforcement

30 CFR Part 950

[SATS No. WY–041–FOR; Docket ID OSM–2011–0020]

Wyoming Regulatory Program

AGENCY: Office of Surface Mining Reclamation and Enforcement.

ACTION: Proposed rule; public comment period and opportunity for public hearing on proposed amendment.

SUMMARY: We are announcing receipt of a proposed amendment to the Wyoming regulatory program (hereinafter, the “Wyoming program”) under the Surface Mining Control and Reclamation Act of 1977 (“SMCRA” or “the Act”).